Assembly Committee on Revenue and Taxation

Assemblymember Rudy Bermudez, Chair

Informational Hearing
Summary Report

Sales Taxation of Jet Fuel

September 28, 2004

San Diego, California

History of State and Local Sales and Use Tax on Sales and Purchases of Jet Fuel

The state sales tax was created by the Legislature in 1933 to offset the tremendous drop in property tax revenues brought on by the Great Depression. The sales tax, paid by retailers engaged in business in the State, applied to all retail transactions involving the transfer of tangible personal property, except those specifically exempted by law. The law at that time provided no special tax privileges with respect to sales of jet fuel.

From 1943 through 1991, an exemption from the state and local sales tax for sales of any tangible property (including fuel) to a common carrier (which includes commercial air carriers as well as water and rail carriers) was enacted, provided certain criteria regarding shipment was met. The exemption for fuel was applied to that portion of the fuel that was actually transported outside this state. This exemption was modified in 1991 so that the exemption for fuel and petroleum products was no longer available to common carriers. At that time, the State was experiencing significant budget shortfalls, and several major tax exemptions were repealed that year, including the exemption for newspapers and magazines, candy, chewing gum, and snack foods, and bottled water.

In 1955, when the Bradley-Bums Uniform Local Sales and Use Tax Law was enacted into law, the law required each sales and use tax ordinance adopted by a city or county to include a provision that purchases of any property (including fuel) by operators of common carriers and waterbome vessels to be used or consumed in the operation of their common carrier activities principally outside a city or county are exempt from the Bradley-Burns tax.

This exemption was based on the argument that the property (the aircraft or vessels) was assessed and taxed under the property tax laws at a higher rate than the property of other businesses in general and that the tax relief was justified. In addition, these industries argued that without such an exemption, they would pay a local sales or use tax twice on the same transaction in many instances because some counties would conform to the uniform local tax law and others would not.

In 1969, when authorization for new district taxes was first passed by the Legislature (for BART, Southern California Rapid Transit District, and Santa Clara County Transit District) the statutes authorizing the tax also required the tax ordinances to contain a provision for a similar exemption for sales to common carriers and waterborne vessels.

In 1972, SB 90 was enacted to repeal these exemptions, because all counties in California had long since conformed to the uniform local tax law, and the property of those industries was now being assessed and taxed under the property tax laws on a comparable basis with other property.

The aircraft common carrier and waterborne vessel industries, however, argued that they had received no reduction in property taxes since 1956 (since their property was being assessed and taxed in 1956 on a basis comparable to the property of other businesses) and so they should continue to enjoy the exemption. In response to these arguments, the exemption was continued for these industries and remained until 1991.

The 1991 legislation eliminated the local and district tax exemption for fuel and petroleum products sold to common carriers. Sales of other items to common carriers continued to be exempt from tax, and that exemption continues to this day. However, since 1991, sales of fuel and petroleum products to common carriers have generally remained subject to the local and district tax. I say "generally" because the law contains one retraining state and local tax exemption for sales of jet fuel - that provided to air common carriers on an international fight. Therefore, if an air common carrier's final destination were France, current law would exempt the entire sale of fuel purchased in California, even if that carrier had stops in Los Angeles and New York before reaching its France destination.

Bradley Burns Local Sales and Use Tax enacted.

Use Tax enacted.

Tax enacted.

Tax: Exempt

Tax: Exempt

Tax: Exem

SALES TAXATION OF JET FUEL
Informational Hearing
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My contribution to this hearing is to give an appreciation of the volume of jet fuel sold in California and how the state sales and use tax generated from those sales has changed over time.

One key point to keep in mind is that neither the number of jet fuel gallons sold in California nor the dollar amount of those sales are reported to the Board of Equalization. Retailers of petroleum products, including jet fuel, in California report the total amount of taxable sales made in California but do not report this data by commodity. Also, while California does impose an excise tax on jet fuel, jet fuel sold to air common carriers is not subject to that tax.

The data used to prepare the estimates of jet fuel usage in California comes from the U. S. Department of Energy's Energy Information Administration (EIA) which publishes data on jet fuel usage nationwide and for the various states. They also publish weekly data on the price of jet fuel at various locations in the country, with one of those locations being Los Angeles.

A part of this morning's handouts is a table that shows the total gallons of jet fuel purchased in California from 1985 through 2003. Usage of jet fuel showed a generally upward trend from the 1.99 billion gallons purchased in 1985 to the high point of 3.36 billion gallons purchased in 1996. This was an increase of 68.4%. Since 1996 usage has been declining to the 2003 level of 2.82 billion gallons, a decline of 16% since 1996. The events of 9/11 are responsible for a portion of the decline since 2000. Over the entire period, jet fuel sales in California has increased by 41.4%.

During this time frame, there have been two exemptions from the sales and use tax on jet fuel. Prior to 1991, jet fuel used after the first out-of-state destination was exempt. This exemption was repealed during the budget crisis in the early 1990s. Also, beginning in 1989 jet fuel used on international flights has been exempt.

The number of gallons that is subject to the sales and use tax has grown from 1.4 billion gallons in 1985 to a little over 2 billion gallons in 2003, an increase of 47%. Since 1992, the first year that reflects only the exemption for jet fuel used in international flights, taxable jet fuel gallons have increased by 21.9%. Total gallons increased by 24% over the same period, which indicates that the amount of jet fuel used in international flights increased at a slightly higher rate that fuel used for domestic flights.

The amount of state sales and use tax revenue generated by the sales of jet fuel is based both on the total number of gallons purchased and the price of the jet fuel. The price of jet fuel, like all petroleum products, has seen a great deal of volatility, especially in the last few years. During 1985 the average price of jet fuel 85 cents per gallon which is reasonably close to the average price of 88.4 cents that occurred in 2003. But in the intervening period, the price went from a low of 44.7 cents a gallon in 1998, half of the 2003 price, to a high of 94.1 cents per gallon in 2000. The latest price information from EIA shows that for the week of September 13, 2004 the price was $1.43 per gallon, which is 61.7% higher than the 2003 price.

The amount of state sales and use tax revenue at a rate of 4.75%, generated by the sales of jet fuel has increased during this period from $56.4 million in 1985 to $86.2 million in 2003. (The rate of 4.75% was used in order to have a consistent rate throughout the period.) As one might expect the lowest amount of revenue was for a year when both the exemptions were in effect, namely 1989 when the amount was $32.2 million. The largest amount was $103.5 million in 2000, when the price of jet fuel was at its highest point during the period. For the period from 1992 through 2003, when only one exemption was in effect, the average annual state sales and use tax revenue has been $69.1 million.

Attempting to predict what revenues might be generated from the sale of jet fuel in the future is difficult at best. I think we can see that revenues for 2004 will show an increase as there has been a significant increase in the price of jet fuel. Beyond that the amount of state revenues will be dependent on the volatile price of jet fuel and the airlines' response to the changing climate of air travel.

David E. Hayes
State Board of Equalization
Research & Statistics
September 2004

Sales of Jet Fuel in California
Source: Board of Equalization

		Exempt Gallons					
Year	Total Gallons	International Flights `	After 1st out-of-state Destination ^	Taxable Gallons	Price per Gallon	Taxable Sales	State 4.75% Revenue
1985	1,994,141,000	-	598,242,300	1,395,898,700	$ 0.850	$ 1,186,513,895	$ 56,359,410
1986	2,112,766,000	-	633,829,800	1,478,936,200	$ 0.610	$ 902,151,082	$ 42,852,176
1987	2,032,320,000	-	609,696,000	1,422,624,000	$ 0.600	$ 853,574,400	$ 40,544,784
1988	1,996,623,000	-	598,986,900	1,397,636,100	$ 0.580	$ 810,628,938	$ 38,504,875
1989	2,253,546,500	518,450,908	676,063,950	1,059,031,642	$ 0.640	$ 677,780,251	$ 32,194,562
1990	2,245,516,500	540,742,828	673,654,950	1,031,118,722	$ 0.840	$ 866,139,726	$ 41,141,637
1991	2,070,243,500	528,032,167	310,536,525	1,231,674,808	$ 0.634	$ 780,881,829	$ 37,091,887
1992	2,273,366,000	589,722,507		1,683,643,493	$ 0.603	$ 1,015,237,026	$ 48,223,759
1993	2,528,537,500	647,131,131	-	1,881,406,369	$ 0.597	$ 1,123,199,602	$ 53,351,981
1994	2,915,510,500	748,621,462	-	2,166,889,038	$ 0.540	$ 1,170,120,080	$ 55,580,704
1995	3,021,689,000	784,379,096	-	2,237,309,904	$ 0.565	$ 1,264,080,096	$ 60,043,805
1996	3,357,270,000	869,338,208	-	2,487,931,792	$ 0.665	$ 1,654,474,641	$ 78,587,545
1997	3,320,733,500	883,275,262	-	2,437,458,238	$ 0.634	$ 1,545,348,523	$ 73,404,055
1998	3,281,131,000	884,704,476	-	2,396,426,524	$ 0.447	$ 1,071,202,656	$ 50,882,126
1999	3,038,187,000	811,697,230	-	2,226,489,770	$ 0.586	$ 1,304,723,005	$ 61,974,343
2000	3,168,200,000	853,617,631	-	2,314,582,369	$ 0.941	$ 2,178,022,010	$ 103,456,045
2001	3,092,645,000	841,221,089	-	2,251,423,911	$ 0.772	$ 1,738,099,260	$ 82,559,715
2002	2,991,832,000	837,015,863	-	2,154,816,137	$ 0.730	$ 1,573,015,780	$ 74,718,250
2003	2,818,822,000	766,107,900	-	2,052,714,100	$ 0.884	$ 1,814,599,265	$ 86,193,465

This exemption was first operative January 1, 1989

^ This exemption was repealed as of July 15, 1991.

Total gallons = Source - Energy Information Administration (EIA)

International Flights = Source - Based on national averages from EIA

Price per gallon - Source - Average of weekly prices published by EIA

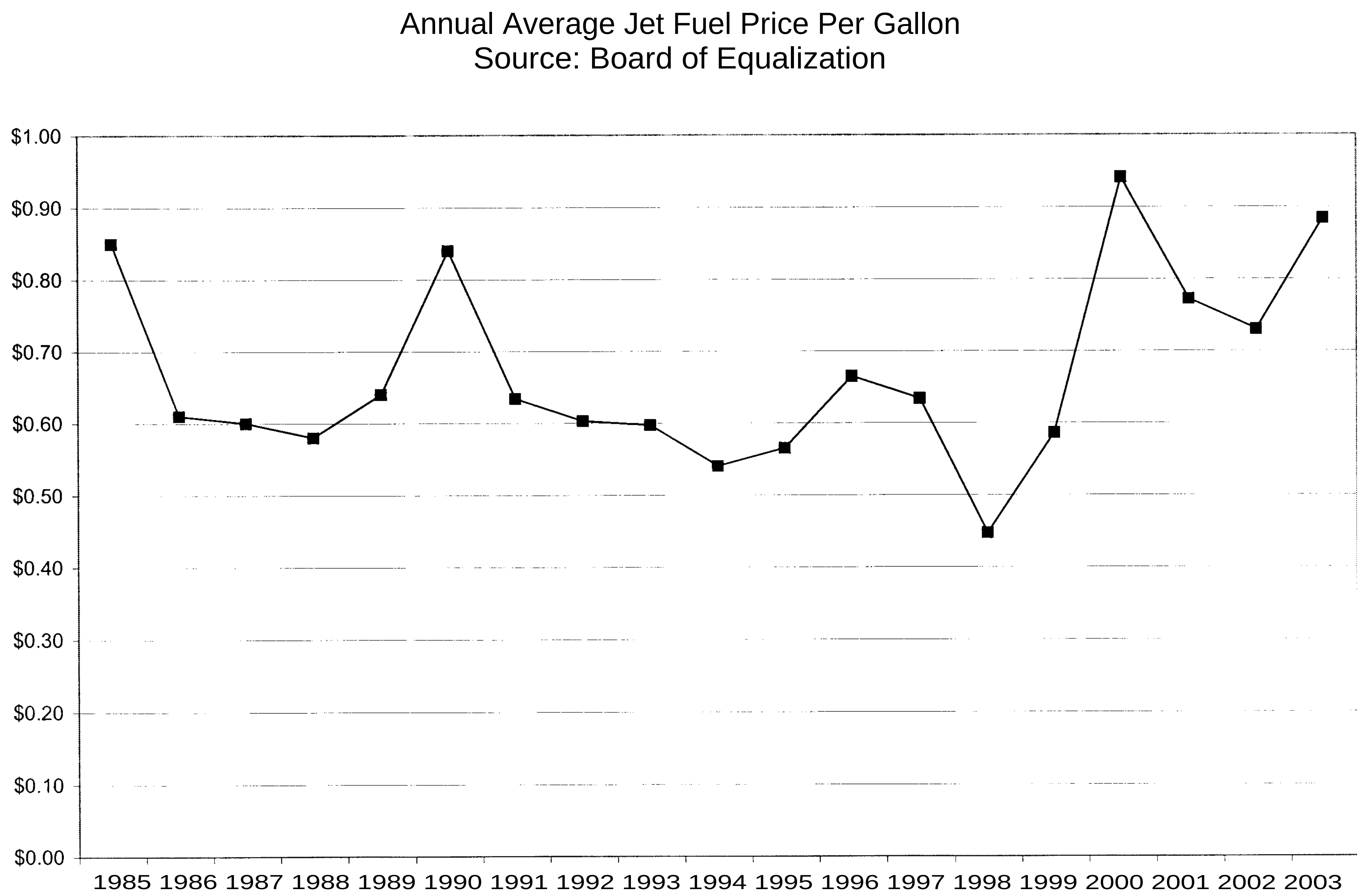

Chart Prepared By Assembly Revenue and Taxation Committee Staff Using Data from Board of Equalization

Taxable Gallons Of Jet Fuel Sold In California
Source: Board of Equalization

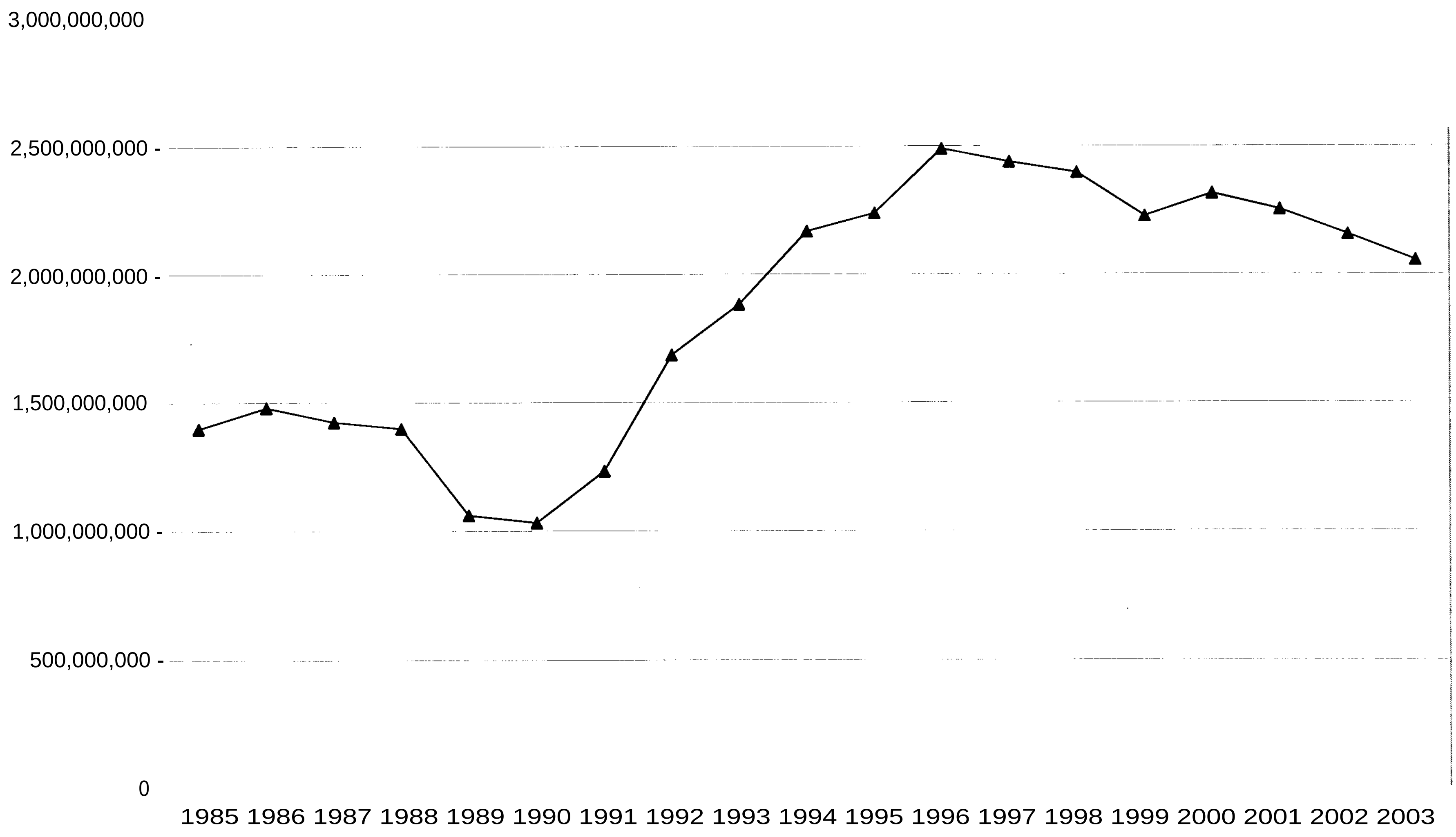

Chart Prepared By Assembly Revenue and Taxation Committee Staff Using Data From Board of Equalization

Total Gallons vs. Taxable Gallons of Jet Fuel Sold in California
Source: Board of Equalization

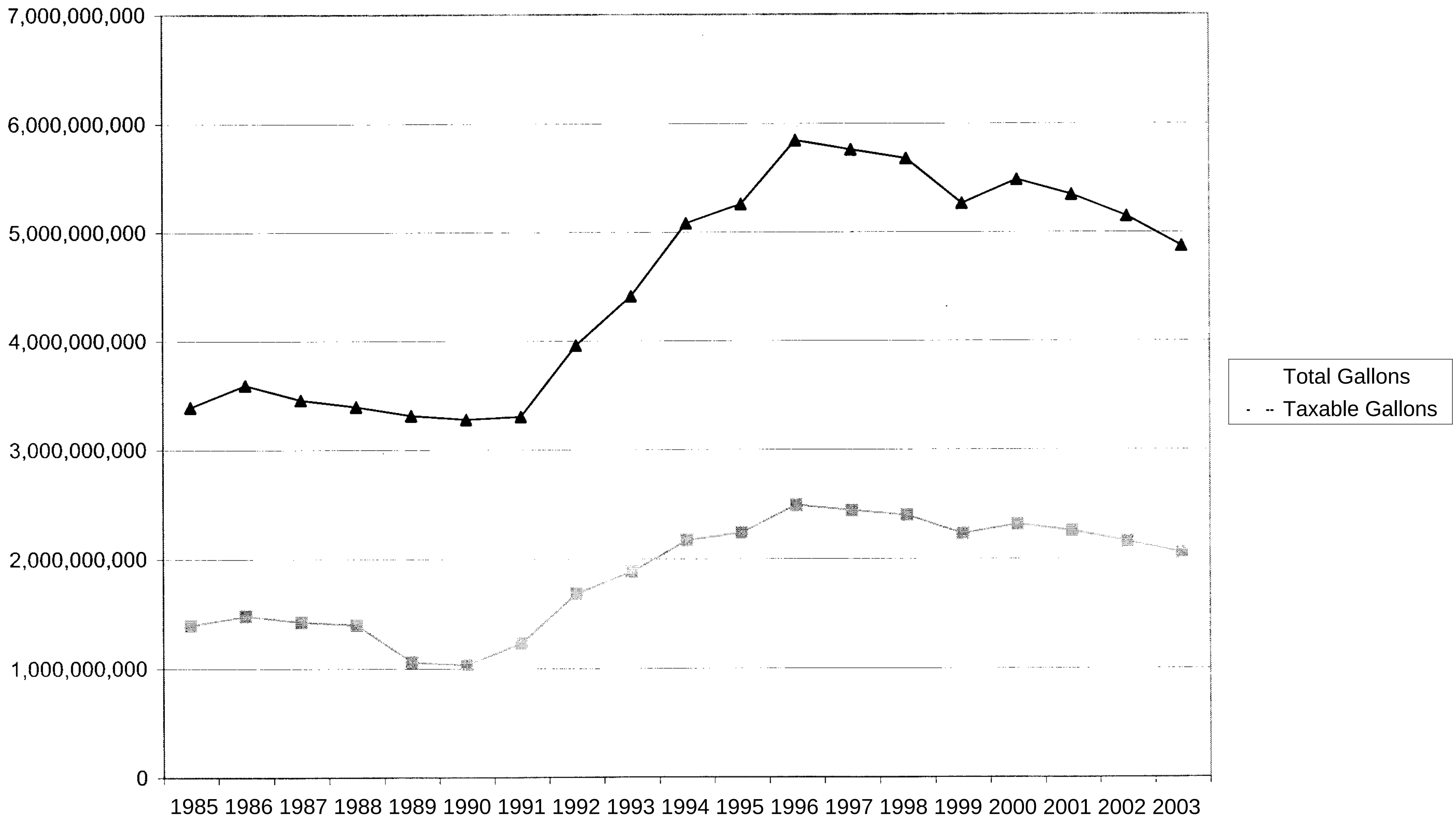

Chart Prepared By Assembly Revenue and Taxation Committee Staff Using Data From Board of Equalization

Effect of Price per Gallon on Total Taxable Sales
Source: Board of Equalization
Total Taxable Sales = Price per Gallon X Taxable Gallons

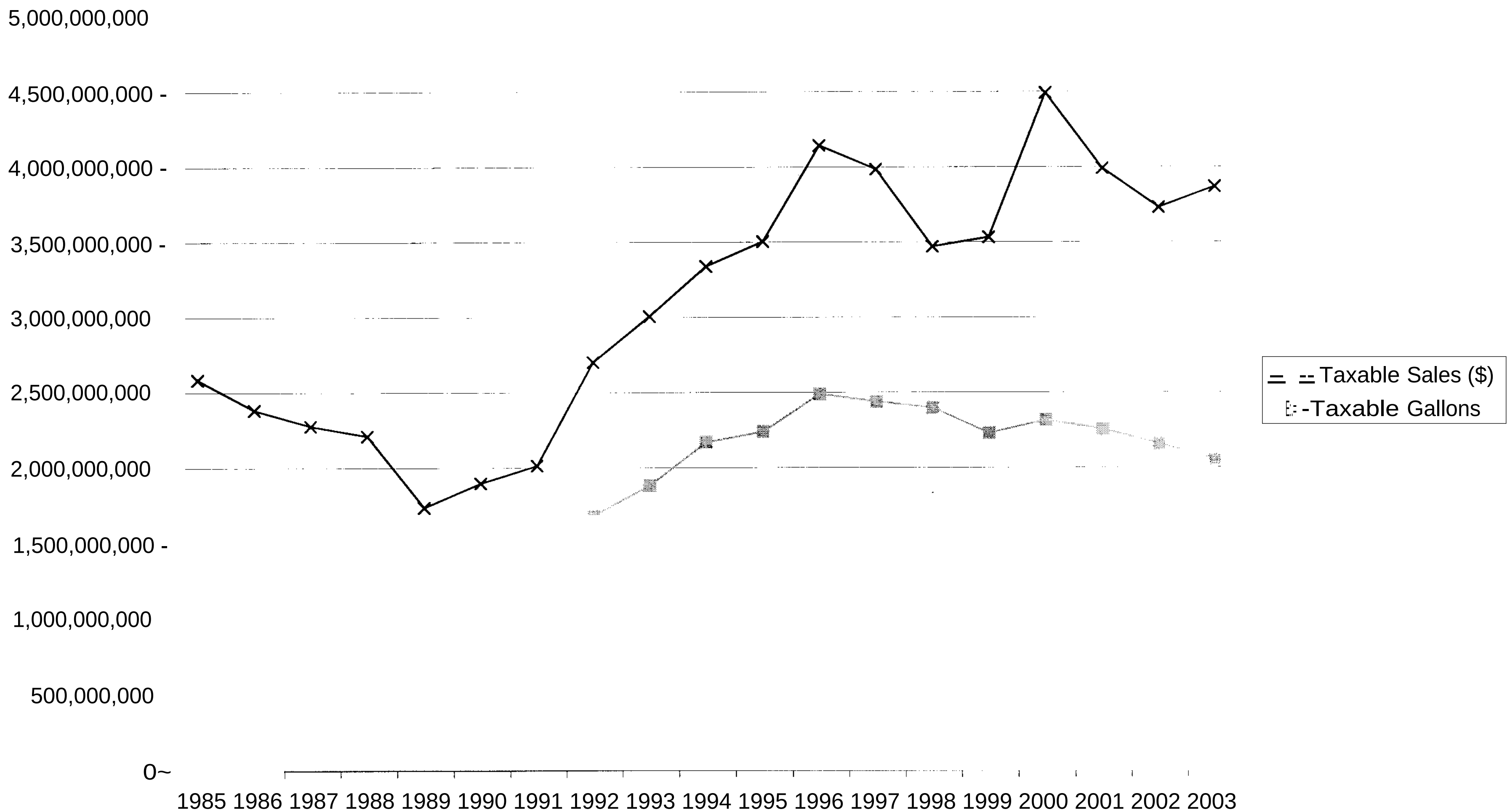

Chart Prepared By Assembly Revenue and Taxation Committee Staff Using Data From Board of Equalization

Average Annual Jet Fuel Price per Gallon vs. Total Jet Fuel Gallons Sold in California
Source: Board of Equalization

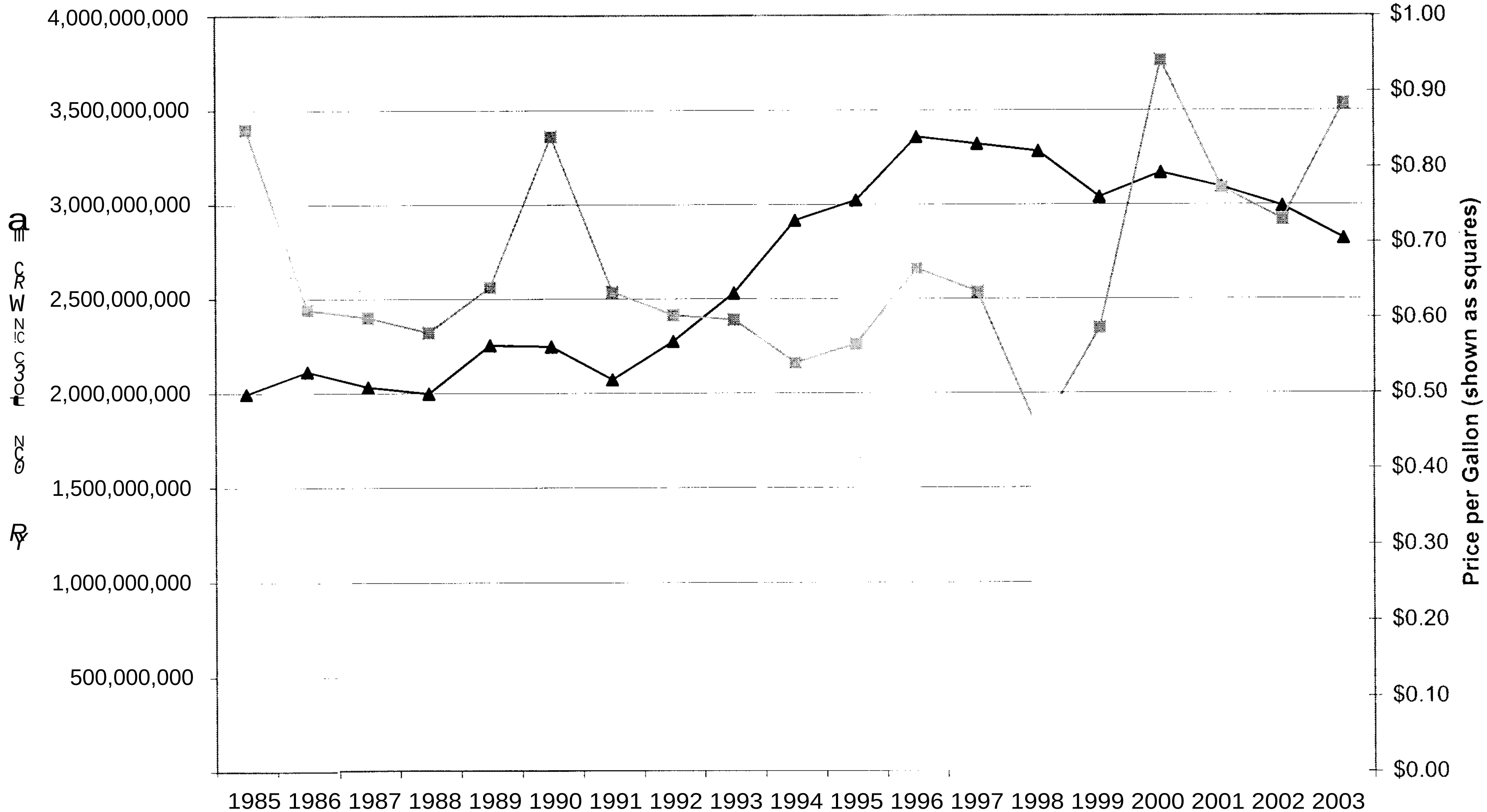

Chart Prepared By Assembly Revenue and Taxation Committee Staff Using Data From Board of Equalization

LAO
60 YEARS OF SERVICE

September 28, 2004

Informational Hearing on Sales and Use Taxation Of Jet Fuel

LEGISLATIVE ANALYST'S OFFICE

Presented To:

Assembly Committee on Revenue and Taxation

Hon. Rudy Bermudez, Chair

LAO ~„

60 YEARS OF SERVICE

Sales and Use Tax Basics

Sales and Use Tax Base. **The Sales and Use Tax (SUT) is a tax levied on the final sales amount of tangible personal property sold in California.**

- **Certain items-such as food and prescription medications-are specifically exempted from the tax.**
- **A few consumer services are also subject to the SLIT.**

Comprised of Two Separate Taxes. **The SUT is comprised of the sales tax-levied on the purchase price of items sold within the state, and the use tax-levied on the use of goods in California purchased outside of the state.**

Current SUT Rates. **The current statewide SUT rate is 7.25 percent.**

- **General Fund-5 percent.**
- **Special Funds-0.5 percent Local Public Safety Fund, 0.5 percent Local Revenue Fund, and 0.25 percent for deficit bond retirement.**
- **Local Portion-1 percent Bradley-Burns. (Some local governments also have optional SUT with rates ranging from 0.125 percent to 0.5 percent.)**

Average Statewide SUT. **Statewide, the average overall SUT rate is approximately 7.9 percent.**

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Sales Taxation of Fuel

Most Fuel Is Subject to the SUT. As tangible personal property, fuel purchased in California is generally subject to the SLIT, but certain special tax treatment has been and continues to be afforded to some fuel purchases.

Fuel Exemptions Existed Before 1991. Prior to 1991, fuel consumed by common carriers (commercial airlines, shipping companies, rail lines, and bus companies) was partially exempted from the SLIT.

- Only the amount of fuel consumed between California and the first out-of-state destination was subject to the tax (the remainder was exempted).
- Fuel used in international commercial flights was also exempted from the SUT.

Legislation Changed the Tax Base. Legislation in the early 1990s first expanded and then reduced the tax base.

- In 1991, the partial SUT exemption was eliminated and all fuel purchased by common carriers in California was subject to the SUT (except for international commercial airline flights).
- In 1993, the partial exemption was reinstated-but only for fuel consumed by water common carriers. The tax treatment of fuel consumed by commercial airlines on domestic flights continued to be fully taxed.

International Agreement for Truck Fuel. Fuel purchased in California by the trucking industry is fully taxed, but the combined SLIT and excise taxes (the "wrapped rate") is allocated among all states party to the International Fuel Tax Agreement (IFTA) based on where the fuel is consumed.

Figure 1 shows the current SUT treatment of fuels consumed by common carriers.

Figure 1

Comparative Treatment of Fuel Sales Under the SUT

Consumer	Tax Base
Water common carriers	Amount consumed to first out-of-state destination.
Air common carriers (domestic)	Full amount of fuel purchased.
Air common carriers (international)	Untaxed, even if flights include a domestic landing.
Rail transport	Full amount of fuel purchased.
Truck transport	Full amount of fuel purchased initially, but allocated based on consumption through international tax agreement.

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Sales Tax Treatment Alternatives

Tax Policy Considerations. In our report Sales *Taxation of Bunker Fuel,* (January 2001), we indicated that, conceptually speaking, the SUT should be levied on tangible property purchased and used in California. To the extent that a portion of aircraft fuel purchased in the state is used outside of California, a partial SUT exemption on fuel purchases has some merit.

Tax Administration Considerations. Special tax treatment for certain purchases should be structured to mesh with the conceptual basis of the tax, but also be relatively straightforward to administer. The SUT treatment of commercial airline fuel should meet both of these tests.

Tax Alternatives Exist. Some alternatives for the SUT treatment of aircraft fuel are presented below, along with an estimate of the annual revenue impact on the General Fund at the 5 percent rate. These options are representative of alternative means of addressing the policy issues raised above.

> *Option 1:* Levy the SUT on domestic flight fuels purchased in California and consumed between California and the first domestic out-of-state destination. This would return the tax treatment to what existed prior to 1991. (General Fund Revenue Loss: Approximately $30 million.)
>
> *Option 2:* Levy the SUIT on domestic flight fuels purchased in California and used between takeoff and the California stateline on outgoing flights. (General Fund Revenue Loss: Mid to high tens of millions of dollars.)

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60 YEARS OF SERVICE

Sales Tax Treatment Alternatives *(Continued)*

Option 3: Levy the SLIT on domestic domestic flight fuels purchased in California and used between takeoff and the California stateline on outgoing flights, and on fuels used between the California stateline and landing on incoming flights. (General Fund Revenue Loss: Low to mid tens of millions of dollars.)

Option 4: Limit the annual SLIT liability to 50 percent of the current SLIT liability. (General Fund Revenue Loss: Approximately $60 million.)

Option 5: Limit the annual number of gallons of total fuel purchased that is subject to the SUT to 33 percent of the current amount purchased. (General Fund Revenue Loss: Approximately $80 million.)

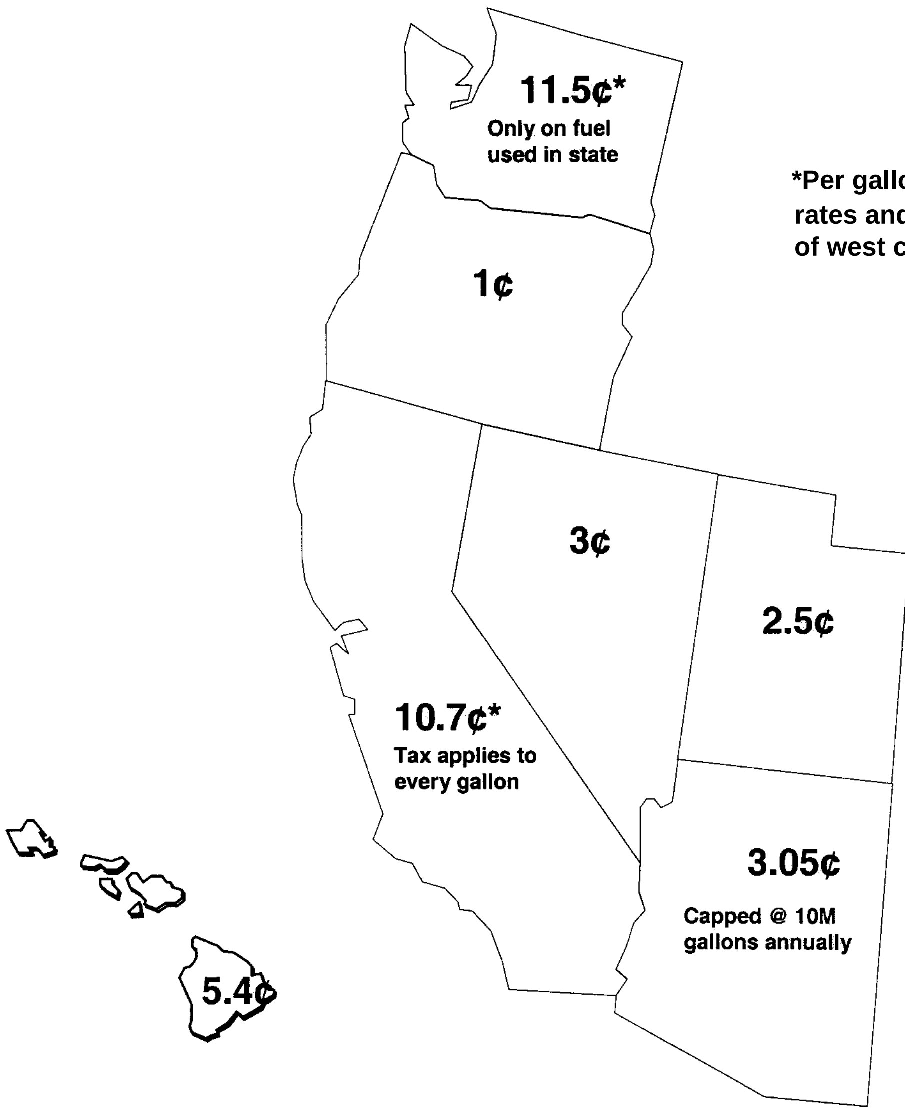
Option 6: Exempt all fuel sales to commercial aircraft that are not currently exempt. (General Fund Revenue Loss: Approximately $120 million.)

California Airline Fuel Tax Relief

AIR TRANSPORT ASSOCIATION

California Taxes Jet Fuel More Than Any Other West Coast State

(State and Predominant Local Taxes)



*Per gallon tax based on sales tax rates and September 8, 2004 average cost of west coast jet fuel of $1.30 per gallon.

Fuel Taxes in Other States

States that do not tax aviation fuel:

- Connecticut
- Delaware
- Indiana
- Kansas
- Maryland
- Ohio
- Oklahoma
- Rhode Island
- South Carolina
- Texas
- Wisconsin

Fuel Taxes in Other States

States that limit taxes:

- Alabama - Exempts airlines that operate at least 15 flights a day to at least 5 cities
- Arizona - No tax on purchases over 10 million gallons annually
- Kentucky - Caps annual liability at $4 million per year
- Missouri - Caps annual liability at $1.5 million per year
- New Jersey - Tax applies only to fuel burned on take-off
- New York - Tax applies only to fuel burned on take-off
- Tennessee - Taxed at reduced 4.5% rate rather than full 7% sales tax rate

Virginia - Rate drops from 50 per gallon to 0.50 per gallon after first 100,000 gallons

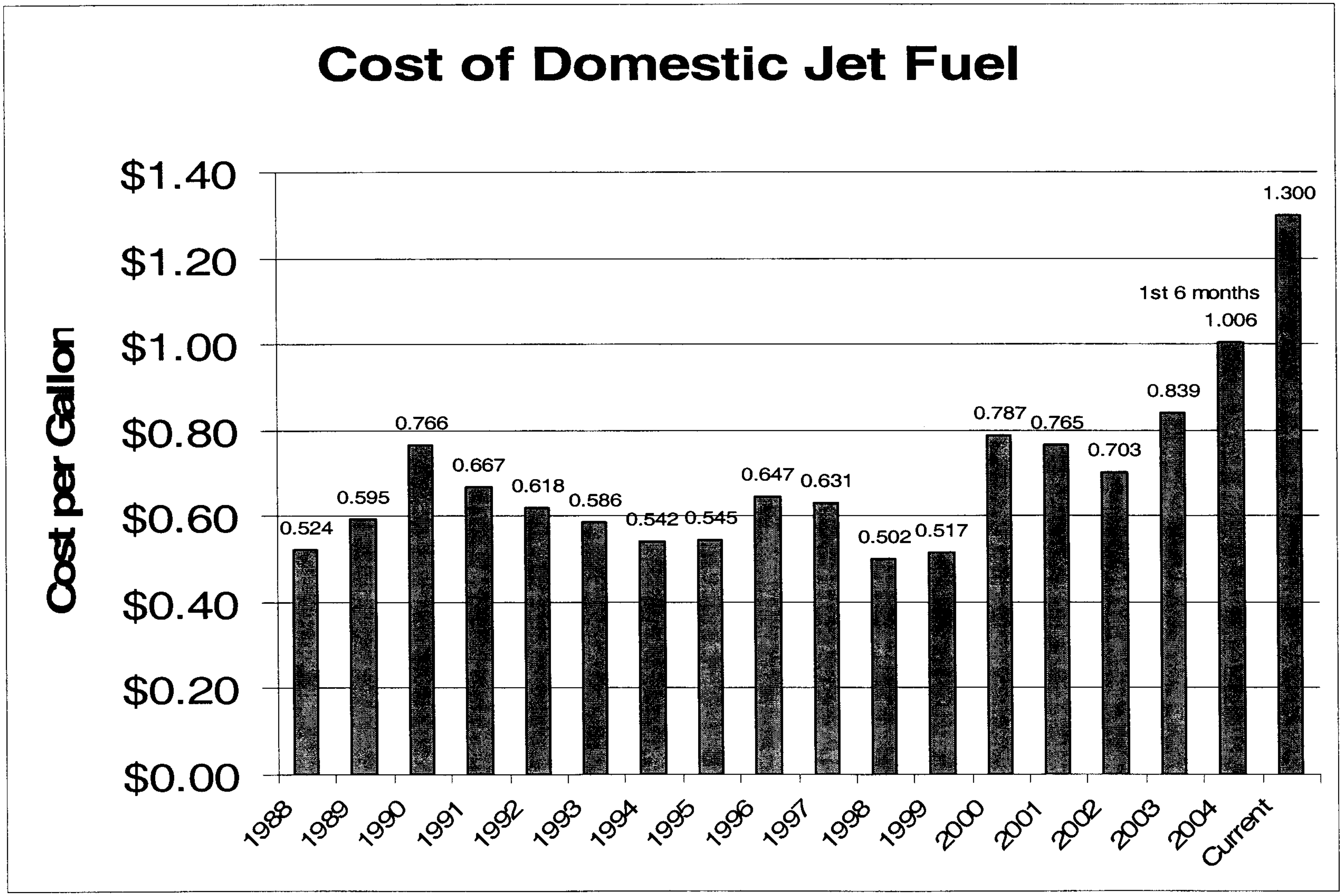
9 Washington - Tax only applies to fuel burned after taking off in state

Fuel Taxes in Other States

Other Significant Aviation States

- *Colorado - 2.9% state tax, .8% local tax, 40 Denver tax*
- *Florida - 6.90 per gallon*
- *Georgia - 4% state tax, 2-3% local tax*
- *Illinois - 6.25% state tax, 2.5% local tax, 50 Chicago tax*
- *Massachusetts - 50 City of Boston tax*
- *Michigan - 6% state tax*

The Cost of Jet Fuel Has Risen Exponentially



Effect of Higher Fuel Prices

- In 2002, the airlines purchased approximately 1.8 billion gallons of jet fuel for domestic use in California.
- At the average 2002 price of fuel of 70.3¢ per gallon, we paid $104 million in California sales taxes.
- At the current price of $1.30 per gallon, we would pay $193 million in sales taxes on the same amount of fuel.
- California would reap an $89 million windfall for which it did nothing to earn.

Loss of Prior Exemption

- During California's last fiscal crisis in 1991, the airlines lost their partial exemption for jet fuel.
- That exemption only taxed the fuel purchased in California that was used in reaching the first stop outside of the state.
- While many other industries also lost exemptions in 1991, virtually all of the others have been restored.
- We estimate that the lost exemption has cost the industry over $400 million.

The Airlines are Major Contributors to California's Economy

- By providing vital transportation services to California residents.
- By employing tens of thousands directly, and many times more than that in related businesses.
- By paying over $250 million in state and local taxes in 2003.
- By paying approximately $700 million in airport rents and landing fees in 2003.

Why is Tax Relief Important Now?

- Industry Losses:

2001:	$8.3 billion
2002:	$11.3 billion
2003:	$3.6 billion
2004:	$6+ billion estimated

- $30 Billion over 4 Years!
- Every $ is important

Alternative Methods of Fuel Tax Relief

Potential Means of Providing Relief Include:

1. A burn-off approach where only fuel used within the state is taxed.
2. Applying a reduced rate of tax to jet fuel.
3. A cap on the price of jet fuel that would be subject to tax.
4. Exempting jet fuel from the sales tax and imposing an excise tax of a fixed amount per gallon.

Recommendation

We urge the Committee to consider a cap on the price of fuel subject to tax.

We believe this provides state and local governments with some degree of consistency, while providing airlines with some protection against aberrational fuel prices.

We would suggest the cap be set at the average price of fuel over a multi-year period.

If the price-cap approach does not work, we recommend that the Committee consider an excise tax of a fixed amount per gallon.

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Testimony of Robert Gransee
Manager of Tax, United Airlines
Before the Assembly Revenue and Taxation Committee
Informational Hearing on Sales Taxation of Jet Fuel
September 28, 2004
San Diego, California

My name is Robert Gransee. I am Manager of Tax at United Airlines. On behalf of United, I would like to express my appreciation for the opportunity to testify today.

For an airline, jet fuel is the second-highest expense after labor. At United, fuel expenses represent approximately 17% of its total costs. United is expected to purchase over 2.35 billion gallons of fuel this year. Thus, every 1-cent a gallon increase in the cost of jet fuel will result in at least $23,500,000 of additional costs to the company. Fuel costs for United this year are anticipated to be about $3 billion. Taxes, of course, are part of the overall cost of jet fuel. United paid over $26 million in jet fuel taxes to California last year.

During his testimony, Mr. Hulquist showed that the tax cost at the recent fuel price of $1.30 was the highest in California compared to any other West Coast state. I wish to spend a few minutes expanding the comparison.

Attached is an analysis of the tax cost for 15 states in which United boarded over 90% of its domestic jet fuel in a recent month. The analysis indicates the tax cost based on fuel prices not only at the recent $1.30 per gallon, but also at $1.00 and at $0.70. At both $1.30 and $1.00, only Illinois has a higher tax cost than California. Even at a fuel price of $0.70 per gallon only three states, Colorado, Florida, and Illinois are higher.

Many of the states where United boards fuel recognize the fact that an airline does not consume all of the fuel loaded into its tanks within the states' borders. Accordingly, these states provide some type of tax relief. That relief takes various forms such as no taxation at all, minimal taxation by taxing only the fuel burned to the border, reduced sales tax rate, or a reasonable cent per gallon tax.

Since California sales/use tax on jet fuel is calculated as a set percentage of the sales price, the tax on each gallon purchased increases when the sales price increases. If the average fuel cost in 2004 should increase 30 cents per gallon over 2003 prices (e.g. from around $0.85 per gallon to $1.15 per gallon-a realistic possibility), airlines will be paying an extra 2.5 cents per gallon in jet fuel taxes for California purchases. For United,

this is significant. United anticipates purchasing about 350 million gallons of taxable fuel in California in 2004 (about the same as in 2003). **However, a 2.5 cent per gallon increase in tax will mean that California fuel taxes paid by United will increase this year by about $8.75 million even though the gallons purchased are expected to remain flat. One might argue that this results in a windfall for the state. Certainly, establishing a cap or a reasonable cent per gallon tax would assist in alleviating the future additional tax burden caused by substantial increases in the price for jet fuel.**

In order to control fuel costs, United maintains a fuel management system. This system tracks the daily cost of jet fuel, including state and local fuel taxes, at all airports. Using this system, fuel is boarded at the most cost effective locations. For instance, the price differential of jet fuel, before taxes, for fuel boarded in Portland compared to fuel boarded in San Francisco is generally minimal. However, the taxes on jet fuel are significantly higher in San Francisco compared to Portland. Consequently, United may board in Portland, for a trip between Portland and San Francisco, more fuel than necessary. This allows United to board less fuel in San Francisco for the next trip. The additional costs incurred in carrying this extra fuel in our tanks is less than paying the higher taxes for fuel boarded in San Francisco. We refer this process of ferrying excess fuel as "Tnkering". Tankering shifts boarding of fuel from higher cost locations to lower cost locations. Consequently, higher cost jurisdictions are losing the extra fuel tax revenue that would have been generated if the fuel had not been boarded elsewhere. In addition, other local benefits are being lost, such as the jobs needed to sell, purchase, and deliver such fuel.

The cost of jet fuel is taken into consideration by United in the making of many significant business decisions. This ranges from determining whether it is economically feasible to increase flight frequencies between city pairs to the type of aircraft (wide body, narrow body, or regional jets) to be flown. California can improve the business climate for United and the rest airline industry by instituting meaningful jet fuel tax reform.

I hope my testimony today has provided some useful information for your examination of California jet fuel taxes.

United Airlines			
Tax Cost Per Gallon			
States Where Majority of Fuel Boarded			
Price Per Gallon of Jet Fuel	$1.30	$1.00	$0.70
	Tax Per Gallon	Tax Per Gallon	Tax Per Gallon
Texas -Exempt	No Tax	No Tax	No Tax
Maryland -- Exempt	No Tax	No Tax	No Tax
New York -- 5.4 cents per gallon but only applies to fuel burned to border	< 1/2 cent	< 1/2 cent	< 1/2 cent
New Jersey -- 4 cents per gallon but only applies to fuel burned to border	< 1/2 cent	< 1/2 cent	< 1/2 cent
Washington -- 8.8% (Seattle) - but only applies to fuel burned to border	< 1/2 cent	< 1/2 cent	< 1/2 cent
Virginia -- 5 cent per gallon for first 100,000 gallons and then .5 cents per gallon	1/2 cent	1/2 cent	1/2 cent
Oregon- 1 cent per gallon	1 cent	1 cent	1 cent
Pennsylvania -- 1.8 cents per gallon	1.8 cents	1.8 cents	1.8 cents
Nevada - 3 cents per gallon	3 cents	3 cents	3 cents
Massachusetts -- 5 cents per gallon (Boston)	5 cents	5 cents	5 cents
Hawaii-- 4.1667%	5.4 cents	4.2 cents	2.9 cents
Florida -- 6.9 cents per gallon	6.9 cents	6.9 cents	6.9 cents
Colorado - 3.7% plus 4 cent per gallon (Denver)	8.8 cents	7.7 cents	6.6 cents
California (7.75%) ONT, SAN, SMF, SNA	10.1 cents	7.8 cents	5.4 cents
California (8.25%) LAX, SFO, BUR, SJC	10.7 cents	8.3 cents	5.8 cents
California (8.75%) OAK	11.4 cents	8.8 cents	6.1 cents
Illinois -- 8.75% plus 5 cents per gallon (Chicago)	16.4 cents	13.8 cents	11.1 cents

SOUTHWEST AIRLINES CO.

Rose Valentinetti
Director, State & Local Taxes

INFORMATIONAL HEARING ON

SALES TAXATION OF JET FUEL

TESTIMONY BY

ROSE VALENTINETTI

DIRECTOR, STATE & LOCAL TAXES

SOUTHWEST AIRLINES CO.

BEFORE

ASSEMBLY REVENUE AND TAXATION COMMITTEE

TUESDAY, SEPTEMBER 28, 2004

Mr. Chairman and members, my name is Rose Valentinetti, Director, State & Local Taxes at Southwest Airlines Co. ("Southwest"). Thank you for your interest in jet fuel tax policy for the state of California. This is an issue of critical importance for Southwest.

I would like to begin by describing the current business operations of Southwest in California. As of October 31, 2004, Southwest will operate 624 daily flights out of eight airport locations in California: Burbank, Los Angeles, Oakland, Ontario, San Diego, San Jose, Sacramento and Orange County. Our daily flights out of California represent 22% of our total daily operations.

As of yesterday, September 27, 2004, our California employees number 4,478, 14% of our total employee population. For the calendar year 2003, Southwest enplaned 18 Million Passengers and handled 56 Million pounds of cargo.

During calendar year 2003, Southwest's California direct expenditures for Salaries & Benefits, Fuel, Landing Fees and Other Expenditures totaled $580.5 Million. Based on the first six months of 2004, Southwest expects total California direct expenditures to approach $640 Million.

Southwest Airlines is a company of people. In addition to the economic contribution attributed to our operations in California, Southwest is proud of its role in participating and partnering with a multitude of Civic and Charitable organizations such as Childrens

Hospital Oakland, Chinatown Community Development Council, Operation HOPE, Senior Community Centers of San Diego. Southwest also serves on several boards/committees including the San Diego County Hispanic Chamber of Commerce, National Hispanic Media Coalition (NHMC) (Los Angeles) and Heart of Los Angeles Youth (HOLA), to name a few.

California is an important State for Southwest. We bring frequent service and low fares to millions of customers every day. Giving back to the community is our way of saying thanks!

Now **for the bad news. The airline industry is in the midst of a crisis. Two major air carriers are currently in bankruptcy. One major air carrier is precariously close to filing and one major air carrier narrowly missed filing last year.**

Low fare carriers are not immune to the difficulties facing the airline industry. Although able to eke out a profit, Southwest is also feeling the squeeze with increased labor costs and skyrocketing jet fuel prices. Upon announcing our August traffic, Gary Kelly, CEO of Southwest, commented "Southwest Airlines is not immune to industry revenue pressures as we, too, experienced weaker August revenue yields." Our percentage of full fare tickets continues to decline as the demand for discounted tickets increase. Over the last four years, our fare mix for full fare passengers declined 4%, indicative of the weak revenue environment.

Fuel cost is our second largest expense after labor. In 2004, fuel expense is expected to increase 45%, which translates into $375,000,000 in additional fuel cost. Southwest is experiencing record increases in sales tax paid on jet fuel as a direct result of record breaking increases in the price of jet fuel. Fuel tax is our second largest State & Local tax expense after property taxes. California <u>alone</u> represents 33%, a full one-third, of our overall fuel tax expense yet only 22% of our daily operations and 14% of our employee base. In 2004, California fuel tax expense is expected to jump approximately 48% from a year ago. In other words, Southwest is expected to pay an additional $6,000,000 in sales tax on jet fuel to the State of California in calendar year 2004 over what we paid in calendar year 2003.

For illustrative purposes, as of 8/1/04, the base price of Southwest's purchase of jet fuel has risen $.4635 per gallon in Los Angeles as compared to 8/1/03. This has resulted in an increase in taxes paid per gallon from .07208 per gallon to .11011 per gallon, an increase of 52.7%.

It is cheaper to buy fuel at Phoenix and Las Vegas. Our fuel tax expense in Los Angeles increased despite a decrease of 90 flights year over year and a 4.5% decrease in fuel consumption. Due to the impact of California sales taxes, it is more likely Southwest will purchase fewer gallons at California airports.

If California imposed a cent per gallon tax on jet fuel, similar to Nevada and Oregon, Southwest would have paid $5.6 Million and $1.9 Million, respectively, in jet fuel tax in calendar year 2003 as opposed to $13 Million.

For Southwest to remain a viable company we must take control of our costs and we must do it now! With soaring fuel prices, controlling our jet fuel sales tax expense becomes a daunting task. We need your help.

Southwest is in support of alternatives to sales taxation of jet fuel that contains our escalating tax expense and at best reduces our tax expense. Therefore, Southwest strongly supports the price cap on jet fuel as an option for altering sales taxation of jet fuel. Southwest also supports a shift from a sales tax model to a cents per gallon excise taxation of jet fuel model. Southwest also supports a return to the Pre-1991 sales taxation of jet fuel on fuel consumed to the first out-of-state destination.

In short, Southwest is looking for predictability, which we do not have now and containment of runaway tax expense. All of the above alternatives would achieve those goals.

Thank you.

Blue

September 22, 2004

Honorable Rudy Bermudez
Chairman Assembly Revenue & Taxation Committee
State Capital
Sacramento, CA 95814

As one of the newer airlines serving the state of California with both intrastate and interstate service, including service at six cities and a base of operations at Long Beach, JetBlue is concerned about the troubling increase in the California sales tax which airlines pay on fuel.

All airlines, and indeed all consumers, have suffered as fuel prices have risen to record levels this year. While fuel prices have increased nationwide, we are especially impacted in California as the State's taxation formula unduly penalizes aviation fuel consumption in the state. The CA sales tax on fuel has increased nearly 29% during 2004 alone. Given that other taxes in California are already among the highest in the nation, a 29% increase in CA fuel tax is unduly onerous.

JetBlue urges you to consider the consequences of such high CA fuel taxes and how they not only impact our airline and employees, but the decisions our company makes on where to fly our aircraft. As a for-profit entity, and a successful low fare carrier driving intense low fare competition, which benefits our customers - your constituents - our success promotes expanded economic activity and a growing tax base, while increasing tourism and commerce.

We strongly support our fellow air carriers today in requesting that California restructure its tax law on aviation fuel to enable sensible economic growth in the State.

Respectfully submitted,

Robert C. Land
Vice President of Government Affairs and
Associate General Counsel

cc: Jack Berkowitz, Director Corporate Taxation

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September 28, 2004

To: The Honorable Rudy Bermudez, Chair, and
Members, Assembly Revenue and Taxation Committee
The Honorable Gene Mullin, Chair, and
Members, Assembly Select Committee on Airports and the Airline Industry

From: Jean Kinney Hurst, Legislative Representative

Re: Informational Hearing on Jet Fuel Taxation

I appreciate the opportunity to offer comments on the committees' review of taxation of jet fuel in California. I reiterate CSAC's commitment to fully participate in any and all discussions on this critical issue. Our staff can provide data analysis, as well as coordinate participation from county experts in this field as appropriate.

As you are aware, Section 2230 of Revenue and Taxation Code requires that the state reimburse local governments for losses resulting from state sales and use tax exemptions. Of course, most bills include an exemption of this section of law. If the state chooses to provide a sales tax exemption, we have a consistent policy on such measures of requesting either reimbursement of lost revenues or that the exemption applies only to the state portion of the sales and use tax rate.

Local officials' options for controlling revenues are limited. Boards of supervisors and city councils that govern airports should have the ability to offer appropriate fiscal incentives that assist them in meeting the needs of the community the airport serves within their local resources. To be clear, we believe that the local governing board is the appropriate body to offer a tax or fee break with local funds.

As an example, Sacramento County provides a wide range of fiscal incentives to new and incumbent carriers, according to service priorities set by the board of supervisors. These incentives include funds for marketing and advertising, credits for landing fees and terminal rents, and establishing formal relationships with local businesses, among others.

Airports require local services: streets and roads, police and fire, water and sewer, public transit, parking, etc. Those services require a funding source, especially with the ever-increasing costs of homeland security. While local governments greatly value the economic benefit of local airports, we ask that the committees recognize the required costs, as well, when considering alternative taxation policies.

While CSAC is in strong support of Proposition 1A on the November ballot, it is not a panacea for cities and counties. The measure was a compromise that prevents the state from enacting another permanent property tax shift and from reallocating the local sales tax. However, local governments will pay $1.3 billion this year and next to assist in the state's budget crisis. Additionally, we continue to pay the original ERAF shift, now totaling more than $5 billion annually. We certainly understand the argument of righting the wrongs of the early 1990's - when it comes to ERAF, we've been making that argument unsuccessfully for years.

When considering the alternatives offered by the Legislative Analyst's Office, please keep in mind that the estimated revenue losses include only the impact on the state General Fund; however, local losses will occur as well. Further, we pledge to carefully review and analyze all options offered by the LAO and the airline industry. We would note, however, that we would oppose the imposition of an excise tax as a replacement for the sales and use tax, as an excise tax is structured without any revenues to local governments. We would also oppose a full tax exemption for jet fuel, as outlined in the LAO Option 6.

Again, we are certainly interested in continuing discussions on this important issue and look forward to participating in future hearings.